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1875 CONNECTICUT AVENUE, N.W.
WASHINGTON, DC 20009-5728
(202) 986-8000
TELEX: 440274 FACSIMILE: (202) 986-8102

WRITER'S DIRECT DIAL:
(202) 986-8050

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February 29, 2000

VIA HAND DELIVERY

Mr. Vernon A. Williams
Secretary, Surface Transportation Board
Room 2215
1201 Constitution Ave., N.W.
Washington, D.C. 20423

Re: Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Secretary Williams:

Enclosed are the original and ten copies of the "Statement of Edison Electric Institute" for filing in the above-referenced proceeding, and a diskette containing the Statement in WordPerfect format.

Also enclosed are three additional copies for date stamping and return via our messenger.

The oral presentation on Thursday, March 9 will be made by Edward H. Comer, Esq., EEI's Vice President and General Counsel. He will be accompanied by the undersigned.

Very truly yours,

Michael F. McBride

Michael F. McBride

Attorney for Edison Electric Institute

Enclosures

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UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
SURFACE TRANSPORTATION BOARD

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EX PARTE NO. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

STATEMENT OF EDISON ELECTRIC INSTITUTE

Michael F. McBride
Bruce W. Neely
Margaret F. Hardy
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
1875 Connecticut Ave., N.W.
Suite 1200
Washington, D.C. 20009-5728
(202) 986-8000 (Telephone)
(202) 986-8102 (Facsimile)

Attorneys for Edison Electric Institute

Due Date: February 29, 2000
Dated: February 29, 2000

Statement of Interest

Edison Electric Institute ("EEI"), the association of investor-owned electric utilities, hereby submits its statement on rail merger policy. EEI applauds the Board for convening this proceeding, because the railroad industry is at a crossroads, and the result of this proceeding may be the most important factor in determining what the railroad industry will ultimately look like in the future.

EEI's primary interest in this matter stems from the transportation of coal, which is used to generate well over 50% of the electricity in the Nation. Coal also is the single largest source of revenue to the railroad industry, accounting for at least 25 percent of the gross revenues of the Class I railroads and, certainly, more of their net revenues. Railroads have enjoyed a revival of fortune in the last 20 years in large part because of the substantial increase in transportation and use of coal. Not only has the volume of coal increased, but also the average length of haul has increased substantially as a result of the switch by many utilities to Western low-sulfur coal to comply with the requirements of the Clean Air Act. Those requirements have only increased the demand for such coal since Congress amended the Act in 1990 to create limitations on the emissions of sulfur dioxide which in turn has increased the demand for low-sulfur coal. Much of that coal is located in the area from southern Montana through Wyoming to Colorado and Utah. Much of the investment capital for the railroads' ability to move Western coal to market has come from the utility industry in the form of long-term contracts which permitted the railroads to finance track and power purchases. In many, if not most, cases, the coal actually moves in shipper-owned or leased cars further alleviating capital requirements for the carriers. Western coal is so important to the railroads that one might as well place a "$" sign over the entire region.

In the entire coal-producing Western region, as well as in the coal-producing region of Appalachia, one finds, with limited exceptions including the joint line in Wyoming, either single-railroad service, no competition between coal sources, or both. This lack of competition distinguishes the railroad industry from the electric industry. It will be difficult to receive the benefits of competition between electric generators when fuel transportation is not equally competitive. With at least one-fourth of the revenue of the railroads coming from these two regions, competitive coal transportation is essential to the economic well being not only of coal, but the economy.

Recently, in Finance Docket No. 33408, the Board approved the construction of a new line into the Powder River Basin by the Dakota, Minnesota & Eastern Railroad ("DM&E"), subject to environmental considerations. The Board has also always considered the mere potential of the building of a new line to serve a particular facility ("build-ins" or "build-outs"), if feasible, as sufficient to create competition that must be protected in rail consolidation proceedings. So, too, the Board must now treat the potential competition from the DM&E as sufficient potential competition to be worthy of protection. As a practical matter, creation of a third competitor in the Power River Basin is the single most important railroad transportation concern of EEI at the present time.

Position of Edison Electric Institute

Mergers are a fact of life in today's economy. Indeed, many of EEI's members have merged over the last several years, and some of its members are seeking approval to merge at the present time. But competition among electric companies in the United States is greater than ever. The Federal Energy Regulatory Commission ("FERC") has, at the same time it has approved most utility mergers, promoted competition in the utility industry and protected customers from any potential adverse effects of such mergers,[1] through measures such as open access to utility transmission facilities and development of regional transmission organizations subject to regulation by FERC. FERC also applies a rigorous competitive analysis using the DOJ-FTC guidelines to evaluate electric mergers. And these mergers are taking place when there is considerable investment by new entrants in the generation of electricity. It is thus hard to imagine that the electric industry will ever have fewer competitors than the number of Class I railroads now in existence. Moreover, FERC has a much broader definition of competitive harm than does the STB and it does not permit customers to be charged higher rates because of acquisition premiums or otherwise to be harmed as a result of a merger.[2]

In contrast, the Board's existing merger policy, which the Board has characterized as "pro-merger," has encouraged the rail mergers of the last 20 or more years that have caused the Class I railroads to shrink in number from about 40 in 1980 to about 7 today, with no more than two railroads now serving any significant market. Unlike FERC, the Board has undertaken no consistent policy to expand customer choices in any significant way, with the possible exception of the Joint Line in the Powder River Basin and some of the shared access areas of Conrail.

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[1] Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, III F.E.R.C. Stats. & Regs. ¶ 31,044, at 30,123 (1996).

[2] Duke Energy Moss Landing LLC, et al., Order Accepting for Filing and Suspending Reliability Must-Run Tariffs, Summarily Dismissing Proposed Acquisition Adjustment, Consolidated Tariffs and Establishing Hearing Procedures, 83 F.E.R.C. ¶ 61,318 (1998), reh'g denied, 86 F.E.R.C. ¶ 61,227 (1999). State regulators, in ruling on utility mergers, have frequently required actual rate decreases or moratoriums on rate increases as terms and conditions of merger approval.

The recent announcement that Burlington Northern Santa Fe ("BN") and Canadian National ("CN") propose to merge has, as the Board well knows, triggered a response from Canadian Pacific, CSX, Norfolk Southern, and Union Pacific opposing the CN/BN merger but stating clearly that, if the Board were to approve it, the inevitable result would be two railroads in North America. See "Open Letter to Rail Customers," published January 11, 2000. That would be unacceptable unless new entrants were able and willing to use the rights-of-way of the two surviving railroads to provide the competition that is necessary.

A future in which there are only two freight railroads in the United States threatens DM&E, or indeed any possibility of a third, coal-carrying Western railroad, because the remaining railroads are not going to allow such a competitor to compete with them in the West or through friendly connections to the Eastern carriers that they would have had to merge with to reduce the number of railroads to two. Thus, future mergers might well require a variety of "Central Corridor" remedies to assure friendly connections for a third coal-hauling railroad in the West.

Railroads can only thrive by serving their customers, not the other way around. They have a common carrier duty to serve the public, but that duty carries with it not just the obligation to quote a rate and to get a shipper's goods to market. Rather, railroads have a responsibility to provide **world-class service.** The promise of the Staggers Rail Act of 1980 was that the railroads would do so if permitted to operate in a **competitive environment** but that promise remains unfulfilled. Instead, the recent mergers, starting with the Union Pacific/Chicago & NorthWestern merger, have resulted in worse service and, at times, have threatened electric reliability and produced higher rates. The shippers, by and large, have suffered as much or more as have the railroads and their stockholders. The service crisis following the UP/SP merger cost this Nation billions of dollars in permanent damage to the economy. Texas alone lost over $1 billion from that crisis. The electric utility industry suffered grievous service failures as a result of the UP/C&NW and UP/Southern Pacific mergers in the West and they cannot afford similar threats to the reliability of the electric system in the East following the split of Conrail between CSX and Norfolk Southern. The reliability of the Nation's electric system should not be subjected to additional risks while the current service problems in the East are unresolved.

In the new environment of wholesale competition between various electric generators, a better relationship between the rail carrier and both the mine and the electric generator is no luxury but a necessity.[3] A competitive electric industry does not have the luxury of carrying long inventories of coal, which might make rail service problems more manageable. It will be necessary for the rail industry to provide nearly just-in-time service as frequently as possible in order to protect the role of coal in electric production. While these concerns might be expected to cause service providers facing competition to lower rates to keep their customers, EEI is concerned that reducing rail competition will lead to higher rates.

For all these reasons, EEI urges the Board to revise its rail merger policy to the broadest extent possible. This is necessary to permit consideration, in proceedings before the Board, of all possible issues of market power, loss of competition and "downstream" effects of the transaction at issue. Specifically, the Board should consider:

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[3] See, e.g., "Broader Power Markets Created by ISOs Could Offer Coal Shippers 'a Larger Range of Opportunities,'" Inside FERC, May 18, 1998 (comments of FERC Chairman Hoecker).

1. Loss of competition;

2. Loss of competitors;

3. Ability of the Board, if any, to replace the lost competition or competitors that result from a consolidation;

4. The geographic scope of the railroad created by the consolidation and whether the consolidated railroad will be able to provide efficient and timely service in the area;

5. Whether the proposed consolidation is likely to trigger additional mergers leading to a two-carrier North American duopoly;

6. Whether the proposed merger is likely to reduce the ability of new entrants, or non-Class I railroads, to enter markets;

7. Whether origin, not just destination, competition for commodities such as coal is reduced or eliminated by railroad consolidations;

8. Whether the assumption the Board has made in prior consolidation proceedings that there is only "one lump" of monopoly profits and the origin or destination carrier with the monopoly can keep all or most of those monopoly profits is inconsistent with the railroads' efforts to extend their market reach through the consolidation to obtain a greater share of those monopoly profits, and to increase the monopoly profits available on a given movement;

9. Whether "2 to 1" shippers -- i.e., those with service from two railroads which are merging into one -- are the only shippers who should get relief in a railroad consolidation proceeding, or whether the reduction of competitors, especially at origin, from "3 to 2" or "4 to 3" is grounds for relief;

10. Whether railroads should be responsible for losses due to service failures, especially those service failures that result from railroad consolidations;

11. Whether acquisition premiums have been paid to effect a consolidation transaction, thus causing the surviving railroad to be under pressure to raise rates;

12. Whether, even if an acquisition premium has not been paid, the likely outcome of the transaction is to reduce the value of the railroad's publicly traded stock, thereby causing pressure to raise rates; and

13. Whether customer protections that are standard in other regulated industries, such as rate caps, should be required as a prerequisite to any further consolidations.

Conclusion

EEI applauds the Board for conducting this most important proceeding, and for doing so before considering the application of BNSF and CN to consolidate. EEI urges the Board to adopt a new rail consolidation policy that more closely follows the merger policies of other Federal regulatory agencies, such as FERC and the Department of Justice, and to weigh those considerations in determining whether to approve any further consolidations.

Respectfully submitted,

Michael F. McBride

Michael F. McBride
Bruce W. Neely
Margaret F. Hardy
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
1875 Connecticut Ave., N.W., Suite 1200
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